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# Hong Kong Stock Exchange Publishes Two Listing Decisions On Rights Issues

On 29 February 2012, the Stock Exchange of Hong Kong (**HKEx**) published two listing decisions in relation to rights issues. The first confirmed that a PRC issuer’s issue of rights shares under a general mandate was not subject to the 20% discount limit on issue price under Rule 13.36(5) (LD25-2012). The second allowed the issuer to seek a prior shareholders’ mandate for conducting a rights issue after shortening the mandate period (LD26-2012). The following provides a summary of the two listing decisions.

## Listing Decision on Rights Issue By a PRC Issuer Using a General Mandate (LD25-2012)

### Facts

A PRC issuer (**Company A**) listed on the Main Board of HKEx proposed a rights issue of 1 new H or domestic rights share for every 10 existing H or domestic shares held by its shareholders on the record date. The new shares were to be issued at a discount of about 40% to the average closing price of the H shares before the price determination date.

Pursuant to the articles of association of Company A, any issue of new shares including a pre-emptive issue was subject to shareholders’ approval by special resolution in general meeting.

At a general meeting of Company A held a few months previously, a general mandate was granted to Company A by a special resolution passed by its shareholders. The general mandate allowed Company A to issue new shares of not more than 20% of each of the issued H shares and domestic shares within 12 months, and there was no restriction on the issue price of the new shares. Company A had not issued any new shares under the general mandate and it proposed to issue the rights shares under the general mandate.

The issue was whether the rights issue would be subject to a 20% discount limit on issue price under Rule 13.36(5).

### The Regulatory Framework

Rule 19A.38 governs the issue of pre-emptive rights of PRC issuers and provides that the requirements of Rule 13.36(1) and (2) are replaced by the provisions summarised below.

1. Under the replacement to Rule 13.36(1)(a), prior to authorising or issuing shares and except in the circumstances mentioned in Rule 13.36(2), the directors of a PRC issuer are required to obtain the approval by a special resolution of shareholders in general meeting, and the approvals by special resolutions of holders of domestic shares and overseas listed foreign shares (and, if applicable, H shares) (each being otherwise entitled to vote at general meetings) at separate class meetings conducted in accordance with the PRC issuer’s articles of association.
2. Under the replacement to Rule 13.36(2), the approval referred to in Rule 13.36(1)(a) is not required if:
3. the PRC issuer’s existing shareholders have by special resolution in general meeting given approval, either unconditionally or subject to terms and conditions, for the PRC issuer to authorise, allot or issue, either separately or concurrently once every twelve months, not more than 20% of each of the existing issued domestic shares and overseas listed foreign shares of the PRC issuer; or
4. such shares are part of the PRC issuer’s plan at the time of its establishment to issue domestic shares and overseas listed foreign shares and which plan is implemented within fifteen months from the date of approval by the State Council Securities Policy Committee or such other competent state council securities regulatory authority.

Note 1 to Rule 13.36(2) provides that except where independent shareholders’ approval has been obtained, an issue of securities to a connected person under a general mandate given under rule 13.36(2) is only permitted in the circumstances set out in rule 14A.31(3) (which include where a connected person receives a pro rata entitlement to securities in its capacity as a shareholder).

Further, under Rule 13.36(5), in the case of a placing of securities for cash consideration, the issuer may not issue any securities pursuant to a general mandate given under Rule 13.36(2)(b) if the relevant price represents a discount of 20% or more to the benchmarked price of the securities, such benchmark price being the higher of: (a) the closing price on the date of the relevant placing or other agreement; and (b) the average closing price in the 5 trading days immediately prior to the earlier of: (i) the date of announcement of the placing or other proposed transaction involving the issue of securities under the general mandate; (ii) the date of the placing or other relevant agreement; and (iii) the date on which the placing or subscription price is fixed, unless the issuer can satisfy the HKEx that it is in a serious financial position and that the only way it can be saved is by an urgent rescue operation involving the issue of new securities at a price representing a discount of 20% or more to their benchmarked price or that there are other exceptional circumstances.

### HKEx’s Decision

HKEx considered that the general mandate granted to Company A was in compliance with Rule 19A.38. It was a general mandate falling within the replaced Rule 13.36(2)(a), i.e. a general mandate approved by a special resolution in a general meeting and the rights shares proposed to be issued were within the 20% limit on the number of new shares issuable under the general mandate.

The 20% discount limit on the issue price of new shares under Rule 13.36(5) applies only to rights issues falling within the replaced Rule 13.36(2)(b) and not those falling within replaced Rule 13.36(2)(a). Therefore, the proposed rights issue of Company A was not subject to the 20% discount limit under Rule 13.36(5). Further, there was no limit on the issue price of new shares under the general mandate granted to Company A.

Any issue of rights shares to shareholders of Company A who were connected persons would be exempt from the connected transaction requirements pursuant to Rule 14A.31(3), since such connected persons would receive a pro rata entitlement to shares in their capacity as shareholders.

In the circumstances, HKEx concluded that Company A could use the existing general mandate to issue the rights shares under Rule 19A.38.

## Listing Decision On Use Of Advance Shareholders' Mandate For Rights Issue (LD26-2012)

### Facts

A Main Board issuer (**Company B**) entered into an agreement with its controlling shareholder (**Parent Company**), a state-owned enterprise, to acquire a target from the Parent Company for cash consideration. Given that the acquisition was a very substantial and connected acquisition, it was subject to independent shareholders’ approval pursuant to Chapter 14 and Chapter 14A of the Listing Rules, respectively.

Company B intended to finance the acquisition and the target’s business through a rights issue. No underwriting agreement had been entered into by Company B at the time but it was expected that the rights issue would increase the share capital of Company B by more than 50%. Pursuant to Rule 7.19(6)(a), any proposed rights issue which would increase the share capital of the issuer by more than 50% must be made conditional on approval by the independent shareholders in a general meeting.

Since the Parent Company was a state-owned enterprise and intended to take up its entitlement to the rights shares, the acquisition and its subscription of the rights shares were subject to the approval of Mainland regulatory authorities. Company B had obtained legal advice which advised that shareholders’ approval for the rights issue should be obtained before formal applications to the Mainland regulatory authorities could be made.

The issue was whether Company B could seek a mandate for the rights issue from its independent shareholders at the same general meeting to approve the acquisition. At the time, no underwriter had been appointed and the issue price, the number of rights shares and other terms of the rights issue remained undetermined. Company B explained that the uncertainty as to the time required to obtain the Mainland regulatory approval and the then market conditions made the securing of an underwriter and agreement on the terms of the rights issue before the general meeting difficult.

However, Company B confirmed that the rights issue would be made under the following framework:

* the rights issue would be fully underwritten;
* the basis of the rights issue would be limited to one rights share for every existing share held;
* the amount to be raised would fall within a range specified in the circular of the general meeting;
* the net proceeds of the rights issue would be used to finance the acquisition and any remaining balance used to finance the target’s operations; and
* there would be arrangements for shareholders to apply for excess rights shares.

### The Regulatory Framework

Rule 7.19(6) sets out the circumstances in which a proposed rights issue is subject to approval by the issuers’ independent shareholders in a general meeting. One of the circumstances is where the proposed rights issue would increase the share capital of the issuer by more than 50% (either alone or when aggregated with other similar fund raising exercises during the previous 12 months).

Rule 7.19(6)(b) sets out the information that is required to be included in the circular to shareholders. This includes the purpose of the proposed rights issue, the total funds expected to be raised, and a detailed breakdown and description of the proposed use of proceeds.

### HKEx’s Decision

HKEx considered that the purpose of Rule 7.19(6) is to protect the interests of minority shareholders when a proposed rights issue will potentially have a material dilution effect. HKEx further stated that the issuer must provide sufficient information to ensure that an informed assessment of the rights issue can be made by shareholders. Such information will generally include the number of rights shares and the issue price as well as the principal terms of the underwriting agreement. Therefore, approval from shareholders in respect of a proposed rights issue will normally be sought after an underwriting agreement is entered into by the issuer and the terms of the rights issue have been determined.

However, based on the following considerations, HKEx accepted a prior mandate in lieu of a shareholders’ approval on the terms of the rights issue:

* the rights issue was for a specific purpose;
* Company B was able to provide sufficient information for an informed assessment by the independent shareholders, which included the purpose of the rights issue, its maximum dilution effect, the amount to be raised, and details of the intended use of proceeds;
* an independent financial adviser’s opinion on the proposed right issue and its recommendation to the independent shareholders on how to vote would be included in the circular to shareholders; and
* Company B agreed to shorten the mandate period from 12 months to 4 months to address HKEx’s concern that independent shareholders should be given the opportunity to reconsider the proposal taking into account Company B’s circumstances and the market conditions in the event that the rights issue did not materialise within a reasonable period. The revised 4-month mandate period was set with reference to the estimated timetable for obtaining Mainland regulatory approval for the acquisition.

The above listing decisions are available on the website of HKEx:

[Listing decision LD25-2012](http://www.hkex.com.hk/eng/rulesreg/listrules/listdec/Documents/ld25-2012.pdf)

[Listing decision LD26-2012](http://www.hkex.com.hk/eng/rulesreg/listrules/listdec/Documents/ld26-2012.pdf)

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